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HOW TO START A COOPERATIVE

By Irwin W. Rust FARMER COOPERATIVE SERVICE U.S. DEPARTMENT OF AGRICULTURE

# FARMER COOPERATIVE SERVICE U.S. DEPARTMENT OF AGRICULTURE WASHINGTON, D.C. 20250

THE Farmer Cooperative Service conducts research studies and service activities of assistance to farmers in connection with cooperatives engaged in marketing farm products, purchasing farm supplies, and supplying business services. The work of the Service relates to problems of management, organization, policies, merchandising, product quality, costs, efficiency, financing, and membership.

The Service publishes the results of such studies, confers and advises with officials of farmer cooperatives; and works with educational agencies, cooperatives, and others in the dissemination of information relating to cooperative principles and practices.

**Educational Circular 18** 

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#### **FOREWORD**

This circular is intended to be a relatively simple guide to groups interested in a step-by-step approach to organizing a cooperative.

It presents one method by which a group can get a cooperative going. If, at times it seems to take a somewhat arbitrary position, this is merely to make a point. There are several ways to start a cooperative. The author has found the method described here to be one good way.

Farmer Cooperative Service has a number of other publications on the same general subject listed on the back of this circular. Of particular interest to those starting a new cooperative is a circular containing samples of necessary legal documents, entitled Sample Legal Documents for New Cooperatives, FCS Educational Circular 19.

This circular has been materially strengthened by the suggestions and thoughts of a number of the staff members of Farmer Cooperative Service, Farmers Home Administration, Federal Extension Service, and the Office of the General Counsel, U. S. Department of Agriculture.

Joseph K. Knapp, Administrator Farmer Cooperative Service U. S. Department of Agriculture

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### How To Start A Cooperative

Irwin W. Rust Membership Relations Branch Management Services Division

So you're thinking about starting a cooperative—you and your neighbors? But you're not quite sure how to go about it?

Here is a guide to help you—a step-by-step outline of the process of bringing a cooperative into being.

#### What a Cooperative Is

A cooperative is a business formed by a group of people to obtain certain services for themselves more effectively or more economically than they can obtain them individually. These people own, finance, and operate the business for their mutual benefit. Often by working together through such a cooperative business member-owners obtain services not available to them otherwise.

Cooperatives perform one or more of three kinds of functions: Marketing products; purchasing supplies; and providing such services as electricity, credit, irrigation and domestic water, and artificial insemination.

In certain respects, cooperatives are organized like other businesses and operate in the same way. They usually incorporate under the laws of the State in which they have their main office. They draw up bylaws and other necessary legal papers. Members elect a board of directors. The board hires a manager and makes general policies. The manager runs the day-to-day business.

In three important respects, however, cooperatives are unlike other businesses.

- Their main purpose is to serve members—not to provide goods or services for others at a profit.
- Savings over the cost of doing business are distributed to member-owners in proportion to their use of its services, not in proportion to their investment. Dividends, if any, on capital invested in the cooperative are limited.
- Voting control of the business is based on membership—not amount of investment. Usually, each member has *only* one vote.

#### Kinds of Cooperatives

Cooperatives vary greatly in size and in the services they provide.

They range from small local cooperatives with only a few members to large regional cooperatives with thousands of members from several States. The regionals may have individuals, local cooperatives, or both, as members.

Some cooperatives offer only one kind of service; some offer many. The trend today is toward multiple-service cooperatives. For example, a farmer may process and market several products through one cooperative, get some of his farm production supplies through it, and even obtain such services as insurance, market news, and production advice.

The new cooperative will have a better chance to survive and grow if it begins by providing a relatively few simple services. As the members and management gain experience new services can be added.



It takes only a few leaders to spark the process of forming a cooperative.

Usually these leaders are several friends who have a common economic problem they cannot solve in-

dividually. They may be farmers, for example, who lack a market for their products or satisfactory sources of production services or supplies or who need an expensive piece of machinery. Or they may

be nonfarm rural residents who wish to provide themselves with some needed service, such as a better source of drinking water.

They talk their problem over informally, decide that others in the locality may have the same problem, and that a cooperative might solve it.

Next, they set about finding out in general what would be involved in starting such a cooperative. At this point, they look around for someone who is familiar with the cooperative-forming process to work with them in taking this and later steps.

Such a person can often be found through the county office of the State extension service—he may

be the county agent or an extension economist. Other sources of help include an established cooperative, a State cooperative council, credit union league, field office of the Farmers Home Administration, and the district bank for cooperatives.

With the help of their adviser, the leaders get together the facts and figures they need in order to present the idea of the cooperative to other potential members. Usually during this period they discuss their idea informally with other leading citizens in the area, getting some measure of the interest in it.

Next, the starting group calls a general meeting of potential members.

# FIRST MEETING

# RST MEETING OF POTENTIAL MEMBERS

Is there enough interest in a cooperative to justify going any further?

This question may be answered at a general meeting of potential members. If there is sufficient interest, the next step in cooperative formation is also taken at this meeting—the appointment of a committee to survey all conditions under which the cooperative would operate.

#### Arranging the Meeting

The date, the time, and the place of the first meeting should all be as convenient as possible for those who will be asked to attend.

Invitations to the meeting may be extended by word of mouth, through newspapers, by announcements at other meetings, or by any available means. Often the adviser—especially if he is the county agent—has communication facilities that can be used.

With the help of the adviser, the starting group plans a definite program for the meeting and selects a chairman. The chairman should be someone who can conduct a businesslike meeting. It is sometimes a good idea for the adviser to act as chairman, or to be on hand at the meeting to help the chairman if necessary.

#### **Meeting Program**

A carefully prepared factual presentation of the proposed cooperative is the first and main item on the meeting program.

One way to make this presentation is to have one member of the starting group discuss the problem and another member summarize how the proposed cooperative might solve it. In addition, a representative of a similar successful cooperative might tell something about its operation.

After the presentation, there should be a discussion period. Here those at the meeting can be encouraged to express their views and ask questions. The starting group and its adviser should be prepared to answer these questions.

After the matter has been thoroughly discussed, it is time to see if the people present are interested enough in the cooperative to go ahead with a more detailed study of its possibilities. Usually, the chairman determines extent of this interest by asking for a show of hands.

If enough people are interested, the chairman appoints a committee which, with the help of the adviser, will make a survey of all aspects of the proposed cooperative and report back to the group at a later meeting.

At this point, before the meeting is adjourned, target dates should be agreed upon for completion of the survey and for reporting back to the group at another meeting. It is often helpful to plan for periodic reporting on the progress of the survey.

The members of the survey committee should have interest in the cooperative, sound judgment, and business ability. Often these committee members are the ones who later organize the cooperative and become its first directors. Usually the survey committee will seek expert help and advice from people

with experience (p. 11).

In this first meeting no one commits himself to become a member and no policies of the cooperative

are set. But many matters are discussed that the prospective members can think about and inquire into before the next meeting.

# WORK OF THE SURVEY COMMITTEE

The survey committee, with the help of the adviser, has a two-part job. First, it must judge whether the proposed cooperative is likely to be successful and beneficial to its members. Second, if the proposal passes this test, the committee must then work out a specific, detailed organization pattern for the new business.

In doing its job, the committee collects pertinent facts, weighs merits of alternative courses of action, makes decisions. It sets forth its recommendations in a carefully prepared report.

From time to time, as needed, the committee should get the advice or help of experts in such fields as law, accounting, financing, credit, economics, and engineering (see p. 11). They need the constant counsel of someone with a sound knowledge of business operation; a member of the board of directors of a successful cooperative of the kind being organized would be an ideal business counselor.

The main areas the survey committee must explore are: Need for the cooperative; potential membership and volume of business; management skills needed; facilities needed; operating costs; capitalization; and other related considerations.

There are legal requirements and limitations that must be taken into account in virtually every phase of the committee's work in planning the organization (see p. 11). This is one task for which the committee should seek expert advice, usually from an attorney.

#### **Need for Cooperative**

Is there an economic need for this new business? To answer this question the committee first examines how the cooperative may provide services, and estimates the cost of such services. Then it determines whether the cooperative could reduce the cost of these services, or improve them. It may be that the cooperative could perform some intangible function, such as stabilizing prices or encouraging more orderly marketing.

In this connection, the committee may also need

to look into the possibility of finding some other way to improve, or reduce the cost of, existing services. For example, if a marketing cooperative is being proposed, it might be better for producers to establish working relations with an existing cooperative or other marketing agency. Or to broaden present channels of distribution.

If the service the cooperative is to provide is not now available in the area, the committee needs to estimate the probable demand for it and the probable cost or benefit.

A cooperative is not needed unless its members will receive monetary or other benefits from it they would not receive otherwise. If there is no clear-cut economic need for the cooperative, the committee naturally will not proceed farther. To start a new business under such circumstances would do more harm than good.

#### Potential Membership and Volume

In virtually every kind of business there is a minimum volume needed for efficient operation. Even at the start, the volume of business done by the cooperative must be large enough to carry operation expenses and overhead and allow some savings to be built up.

To estimate volume, the committee first estimates potential membership, then the amount of business each potential member would do with the cooperative. In making this estimate, the committee may need to visit or write potential members, asking the extent of their normal use of the type of services the cooperative is to provide.

Estimates of both membership and volume should be conservative. Not all persons interested will join. Not all who join will do so at the outset. And not all members will make fullest use of the cooperative's services.

In estimating volume, it will help to know if prospective members have had experience with cooperatives—and their opinion of this method of doing business.

#### Management Skills Needed

Very simple or small cooperatives are sometimes managed directly by the board of directors. In such instances it is wise for the board to name one director to be in charge, rather than for several directors to attempt to be the boss.

But in most instances a cooperative will need a full-time manager, competent to run an efficient business. The survey committee will not actually employ a manager, but it should assure itself that if a cooperative is organized a good manager could be found. Without good management a new cooperative will not be able to perform satisfactorily the services for which it is organized, no matter how urgently they may be needed.

It is difficult to be specific about what makes a good manager. Ideally the manager should be a person who understands business principles and practices, is familiar with the kind of goods or services the cooperative will provide, and understands the significant features of a cooperative business enterprise.

He is a man who can plan operations and set up controls to insure that plans are carried out. He uses the resources—land, labor, and capital—in the most efficient manner. He has demonstrated his ability to get things done.

#### **Facilities Needed**

What land, buildings, and equipment will be needed? How much will they cost?

The committee bases estimates of these needs on the expected volume of business that will be done by the probable charter members, plus some allowance for future expansion. This estimate should also be conservative; excess capacity is expensive to maintain.

The cost of buying or leasing an existing plant and used equipment, as well as the cost of building a new plant from the ground up, should also be investigated. And, if expensive or elaborate facilities are needed, the advice of skilled engineers or technicians should be obtained.

#### **Operating Costs**

What will it cost to operate the business—both in total and per unit of service?

Estimating operating costs is one of the most important jobs of the study committee. Potential members should not be led to expect greater savings than the cooperative can achieve. The estimated costs

should be compared with existing costs to see if worthwhile savings will be realized.

Operating costs include such items as salaries of the manager and other employees, cost of utilities, taxes, depreciation, and costs of supplies needed. The adviser may need to help the committee determine what items should be included and their probable cost.

If the per unit operating costs of doing the estimated volume of business show little or no savings over present costs, the committee may want to estimate what volume would be needed to make the new business worthwhile. In most businesses per unit operating costs tend to decline as the volume increases.

In order for a cooperative to have the lowest possible operating costs, its members must furnish it with the amount of business it is set up to handle.

#### Capitalization

How much money must I put up to get the cooperative started?

This is one of the first questions potential members will ask. To answer it and others equally pertinent, the committee should work out a suggested plan of capitalization.

This plan should include:

- Specification of the capital structure of the cooperative—that is, whether it is to be stock or nonstock.
- An estimate of the amount of initial capital needed and designation of probable sources of this capital.
  - Provision for revolving-capital financing.
  - Provision for accumulation of capital reserves.

#### Capital Structure

In most States a cooperative may be organized with capital stock or without.

If the association is a capital stock organization, members are issued stock certificates as evidence of their capital subscriptions. More than one type of stock may be issued, but usually no more than two types are necessary. Most stock cooperatives issue one share of common stock per member to show membership. Preferred stock is issued to show additional capital contributions.

If the association is a non-capital stock organization, some kind of certificate—usually a revolving-fund certificate—is issued to show capital contributions of members. Many nonstock cooperatives raise some or most of their original member capital by means of a membership fee.

Whatever the capital structure, it should be kept as simple as possible. If stock is issued, it is well to keep par value low—\$5, \$10, or \$20, for example. Shares of this size are easier to sell, transfer, or pay off than shares of higher value.

#### **Estimating Capital Needs**

Total capital needed by a cooperative depends on the volume of business the cooperative will do, the type of service the cooperative will provide, the nature of the competition the cooperative will face, and the degree of risk the cooperative will take in the day-to-day conduct of its business. Whatever the total amount needed, it will be related to the number of members and volume of business.

Two kinds of capital are needed—fixed and operating. Fixed capital is money to buy such things as land, buildings, and equipment. Operating capital is the money required to keep the business going—paying the light and water bills, paying the employees, and buying the operating supplies, such as packing cartons, office supplies, and miscellaneous items.

There are three possible sources of this capital: (1) The members, who invest in the cooperative to get needed services; (2) the investing public, which may invest capital in the cooperative to earn dividends; and (3) loans from such lending agencies as a bank for cooperatives, a commercial bank, or, in certain cases (described in further detail at right) the Farmers Home Administration.

#### Initial Capital

Initial capital is needed (1) to buy land, buildings, equipment, and other facilities and (2) to operate the business the first year.

Part or all of this original capital will come from the members. Usually some of it comes from outside credit sources.

Contributing initial capital is a basic member responsibility. These initial contributions are actually evidence of good faith of the members—their "earnest money." Local public-spirited citizens may want to supplement members' contributions. After such capital contributions reach a certain level, they can be used as a credit base.

Member Capital.—The members' share of initial capital must be large enough to make them realize they have a financial stake in the business to protect. Also, it must be sizable because no credit source would be likely to take financial risks in a cooperative if its members demonstrate an unwillingness to do so.

It is desirable that each member's share be proportionate to his expected use of the cooperative.

If possible, it should be made in cash. A few members may be able and willing to contribute more than their share. If so, they should be allowed to do so; in a cooperative this will not entitle them to any special privileges.

It has often been helpful, in estimating total capital requirements, to project them by type (for example, operating, facility, and commodity) and then relate each to the membership.

This approach clarifies member responsibility, reveals the extent of capital needed from outside sources, and makes it easier to see the role credit will play in keeping the cooperative going.

How much outside capital the cooperative can get will depend in part on how much initial capital the members are willing to put up. Normally member capital does not have a due date. Thus, the more initial capital the members supply, the easier it will be to get outside credit. At least one-half the initial capital from members is a desirable goal.

However, *if* potential members of the proposed cooperative do not have enough funds or credit to subscribe their share of initial capital, it is possible that they may be eligible for special loans to cooperatives made available under the Economic Opportunity Act of 1964.

The Act authorizes the Farmers Home Administration to make loans and to provide organizing and operating help to certain rural cooperatives. The three conditions that make a rural cooperative eligible for such a loan are:

- It must furnish essential services, supplies, or facilities to its members.
- At least two-thirds of its membership must be low-income families who live in the country or in towns of not more than 2,500 population.
- The cooperative must be unable to obtain the necessary credit from other sources at reasonable rates and terms.

Under the Act, Farmers Home Administration may make loans to pay costs of organizing the cooperative and such related costs as charges for legal service and for appropriate technical, management, and other professional services that cannot be provided from other sources.

Further details can be obtained at the local county office of the Farmers Home Administration.

Facility loans.—Long-term credit from cooperative banks or other outside sources is the usual way of acquiring part of the money to finance facilities—land, buildings, and equipment.

There is no rule covering the maximum percentage of capital for these purposes that should be borrowed, but a provision in the Farm Credit Act of

1933 may serve as a guide. That Act limits the amount that banks for cooperatives may lend to assist cooperatives in constructing, buying, or refinancing facilities to not more than 60 percent of the fair value of security offered.

The period of the facility loan depends on a number of factors, including the policies of the lender. Only under unusual circumstances should the cooperative plan to repay a facility loan in a single year.

The committee should look into the various sources of long-term loans and recommend the agency that can supply the financing most nearly suited to the needs of the organization. The main sources of facility loans are banks for cooperatives, commercial banks, insurance companies, Farmers Home Administration, and other cooperatives.

Under certain circumstances cooperatives may obtain facility loans from the Area Redevelopment Administration through a Rural Community Development Service program.

It is also possible, for cooperatives serving lowincome patrons, to obtain facility loans jointly from Farmers Home Administration and a district bank for cooperatives, under provisions of the Economic Opportunity Act of 1964.

Operating loans.—After the cooperative becomes established it may obtain all of its operating funds from short-term loans (1 year or less). A new cooperative, however, can obtain only part of its operating funds from this source.

For a new marketing cooperative, it is good practice for the members to supply at least one-fourth of the funds for the first year's operating expenses. For supply cooperatives, members should furnish at least half.

The remainder may be obtained from short-term loans from banks for cooperatives or other outside credit sources.

The committee should explore all sources of shortterm credit and recommend the agency that can best meet both the immediate and long-range needs of the cooperative. Among the sources of short-term loans are banks for cooperatives, Farmers Home Administration, commercial banks, and other cooperatives.

#### **Revolving Capital Financing**

The revolving-capital financing plan is peculiarly suited to cooperatives.

Here's the way it works.

As a member does business through a cooperative, he authorizes the cooperative to use a portion of the money he has furnished the cooperative through his patronage. This may be either a specified deduction for each unit of product sold or

bought or a percentage of the savings the member realizes on each transaction. This money is provided and is used for capital purposes only.

This amount (sometimes called a capital retain) is credited to the member on the cooperative's books. At the end of the year the member is issued a certificate in the total amount of his capital retains for the year. This certificate represents member capital invested in the cooperative.

The capital retains go into a revolving capital fund. In the first years of the cooperative's existence, money from this fund usually goes to pay off the long-term loan of original capital. Later on, capital retains are returned to the members year by year, in the order in which they went into the fund. That is, the oldest are paid back first.

The revolving capital plan allows members to build up an equity in their association in proportion to the amount of business they do. It makes it possible to return a withdrawing member's investment. And it gives the business flexibility to meet changing conditions that may cause financial needs to change.

#### Reserves

Like any other business, a cooperative should build up reserves. These reserves are over and above operating reserves for such items as depreciation and bad debts.

Reserves are funds for meeting unforeseen circumstances such as a poor business year. Reserves are also needed from time to time to build new or expanded facilities, or perhaps to add new services. When such a need arises, the cooperative can use its reserves instead of borrowing money, curtailing its services, or impairing its capital. Thus, reserves protect the capital investments of members.

The committee should estimate the amount of reserves to be built up, and the method of providing them.

When reserves build up to the amount considered adequate, they may be revolved out to the members at the discretion of the directors, in the same manner as revolving funds. In some States the amount or percent of reserves is specified or limited by law.

#### Other Considerations

The survey committee will also need to look into numerous other matters related to organization, scope of business, and operating procedures. Some of the points to consider are discussed below.

• Incorporation.—Usually, it is best to incorporate. Most States have special enabling laws under which cooperatives may incorporate. Or, it may be preferable to incorporate under either the general or

the nonprofit section of the State's general corporation enabling act.

Incorporation gives the cooperative a distinct legal standing and a set term of existence. And, generally, members are not personally liable for the debts of an incorporated organization.

However, it is not necessary that a cooperative be incorporated. If the group is small, and the services to be provided are limited in number and complexity, it is possible to operate as an unincorporated cooperative. This may be an easier way to get started.

An unincorporated cooperative is roughly equivalent to a partnership. This means that each member is liable for all of the debts of the organization. It is more difficult for an unincorporated organization to buy or sell land or other physical assets, since such action requires approval of all members.

- Scope of business.—What services will the cooperative provide? Usually it is best to begin modestly, providing one or a few services that can be handled without elaborate or costly facilities—then to expand on a successful start.
- Membership.—How large a territory will members be drawn from? No larger than will permit efficient service.

What will be the qualifications for membership? The ideal member is proud of his cooperative and supports it by patronizing it.

Will there be a membership fee? Generally at least a small fee is desirable.

- Location and hours of business.—Both should be as convenient as possible for efficient use of the cooperative by members.
- Representation on board of directors.—If membership will be widely scattered, it may be desirable to elect directors by districts. Or if the cooperative will market several commodities it may be that the producers of each commodity should be represented on the board.
- Method of payment for products.—There are three methods of accounting to members for products sold through a cooperative. These are outright purchase, selling on individual account, and pooling. Ordinarily, a beginning cooperative does not buy a member's product outright. Instead, it sells these products and gives members the proceeds, minus the expense of selling and the cost of running the cooperative.
- Pricing supplies and services bought by members.—Usually a purchasing cooperative charges its members the prevailing prices for supplies and serv-

ices bought from the cooperative. Then at the end of the fiscal year, savings are returned to members in the form of patronage dividends.

• Organization agreement.—The survey committee should decide if an organization agreement is to be used. If so, they prepare one. (See sample, p. 16.)

An organization agreement is a tool used to determine the extent of serious interest in the proposed cooperative. By signing this document, the signer agrees to belong to and patronize the proposed cooperative and to furnish a specified amount of the initial capital—if a certain number of other prospective members also sign up within a given time period.

If the required number of members sign this agreement, the signers then meet and decide by vote whether enough signatures have been obtained to justify forming the cooperative.

This form, like all legal forms of the cooperative, should be prepared or checked by an attorney.

• Business with nonmembers.—The survey committee should recommend whether the cooperative will do business with nonmembers and, if so, to what extent and under what conditions.

State laws covering cooperatives and State and Federal income tax laws have provisions to be taken into account when deciding the extent of nonmember business.

- Other matters that must be settled before the articles of incorporation and the bylaws can be drafted include the name of the organization, voting procedures, and rules for management of the association. The survey committee may want to make a list of these items and their recommendations concerning each one.
- Organization costs.—The committee should estimate the cost of getting organized and set the amount each prospective member should be assessed to pay these costs. These costs will include such items as attorney's fees and the fee for filing the articles of incorporation.

Prospective members of cooperatives eligible for help from Farmers Home Administration can borrow from FHA to pay the organization cost assessment.

#### The Survey Report

The survey committee sums up its findings and sets down its decisions and recommendations in some orderly arrangement, such as the sample committee report shown on page 13.

All pertinent facts and figures collected by the committee need not be included. But the committee

should have them on hand when it presents its report to the prospective members. They may be needed to answer questions. It is sometimes a good idea to mimeograph the report so that the prospective members can refer to it at the meeting and later.



This second general meeting of potential members is arranged in the same way as the first. It also needs a skillful chairman. Its main item of business is the survey report.

After the report is presented it should be discussed thoroughly point by point. The committee members should enter into this discussion, helping the group understand fully the possibilities for success.

Possibly there may be so many points to cover that it is difficult to discuss them all in one meeting. If so, the meeting can be adjourned at some convenient point and reassembled from time to time until the entire report has been presented.

After the discussion, the chairman determines if there are enough persons who want to go ahead with the cooperative to justify taking further steps. If there is enough interest, the chairman then appoints an organizing committee.

The organizing committee may well contain some or all of the survey committee members. It may be larger than the survey committee, and it is sometimes divided into subcommittees that handle different main jobs.

If all the recommendations of the survey committee have been agreed to, the report can serve as a blueprint for the organizing committee. If the potential members want certain provisions changed, however, the discussion and voting should be continued until all changes are agreed to.

A final piece of business that may be conducted at this meeting is the estimate of each prospective member's share of the costs of organizing.

# WORK

# OF THE ORGANIZING COMMITTEE

The organizing committee has five main jobs: (1) to sign up the required number of members; (2) to obtain the capital subscribed and arrange for capital loans; (3) to draft the legal organization papers; (4) to file the articles of incorporation (if it is to be an incorporated cooperative); and (5) to arrange the first meeting of the original members.

#### Signup

The organization agreement described on page 7 may be used to sign up members. The committee may want to enlist others to help in making a canvass of all prospective members, including those who may not have attended the first meetings. If the area to be covered is large, it is a good idea to assign different teams to each locality.

All who solicit memberships should have a thorough understanding of the way the cooperative is to operate. They should be businesslike in their approach and make no promises about cooperative operation that cannot be fulfilled.

#### **Obtaining Capital**

After enough members have signed up to insure the desired volume of business and the necessary capital, the capital subscriptions should be collected.

All capital collected should be turned over promptly to someone designated by the committee. This person keeps a complete record of all subscriptions.

This committee may also want to look further into probable sources of loans and recommend the ones to be used. It can make no binding agreements for

these loans, however, because the cooperative is not yet legally in existence.

#### **Drafting Legal Organization Papers**

An incorporated cooperative operates within a legal framework made up of articles of incorporation, bylaws, and (in some instances) a marketing agreement. These documents must be drawn up with care to insure that they provide for the kind of operation the incorporators want and that they meet legal requirements.

Other legal documents usually needed are: Membership application, membership or stock certificate, revolving fund certificate, and meeting notices and waivers of notice.

#### Articles of Incorporation

Articles of incorporation are a statement of the kind and scope of business the cooperative is designed to do. This statement must be drawn up to conform with State laws. It is wise to specify rather broad incorporating authority even though at the beginning services may be quite limited.

These articles usually contain: Name of the cooperative (which in some States must contain the word "cooperative"); principal place of business; purposes and powers of the association; proposed duration of the association; names of the incorporators (in most States); specification of the capital structure of the cooperative. In some States, the names of the first officers of the association must be included.

#### **Bylaws**

Bylaws state the way the cooperative will do business. They must be consistent with both State statutes and the articles of incorporation.

Bylaws usually specify: Requirements for membership and rights and responsibilities of members; how membership meetings are called and conducted; how voting is done; how directors and officers are elected, and their number, duties, terms of office, and compensation; time and place of directors' meetings; dates of the fiscal year; and other rules for the management of the association.

For a marketing cooperative that is not to have a marketing agreement, the bylaws should specify the extent of the obligation of the members to market their products through the cooperative. It should also outline the terms and conditions under which the products will be marketed and accounted for.

If the proposed cooperative is being organized for the purpose of participating in price support and storage programs, its operations should be planned and its legal documents drafted in a manner which complies with specific regulations of those programs. Information can be obtained from the nearest county office of the Agricultural Stabilization and Conservation Service (ASCS) of the U. S. Department of Agriculture.

The committee prepares the bylaws, usually in cooperation with an attorney. His services are important in making certain that the bylaw provisions comply with the laws of the State in which the cooperative is incorporated. The committee's role in preparing bylaws is to make certain that the bylaw provisions will not conflict with actual operating procedures.

State laws usually provide that the cooperative must adopt bylaws within a specified time—sometimes 30 days—after the articles of incorporation are filed. The organizing committee arranges a meeting of the incorporators named in the articles for this purpose.

#### **Marketing Agreement**

Many, but not all marketing cooperatives use a marketing agreement. A marketing agreement states the duty and intent of the member to deliver a specified amount or percent of his production to the cooperative.

It sets forth the responsibilities of the association to the members. It also outlines the methods of capitalization and deductions from gross sales for all necessary association expenses.

In this agreement also, the association agrees to accept specified products, to market them to the best of its ability, and to return to members all proceeds of such marketings less deductions for expenses, capital, and reserves.

The association also agrees to issue some evidence of capital retains other than capital reserves.

Among cooperatives requiring a marketing agreement, the continuing or self-renewing agreement is widely used. This is one which specifies that after the agreement has been in force for some stated initial period (say 3 years), it shall continue in force from year to year unless the member (or the cooperative) states in writing a desire to cancel the agreement. Usually this statement must be made during a specified annual withdrawal or cancellation period.

Use of a marketing agreement insures the association sufficient control over the products to be delivered that it may function properly. This is especially helpful in the first few years of operation while the cooperative is establishing its reputation as a going, responsible, and successful business. Marketing agreements have helped some cooperatives get needed outside financial help.

In some States, cooperatives that use marketing agreements must file them with the State government. If so, the marketing agreement should be drawn up so that it is eligible for filing.

A marketing agreement may be drawn up to serve also as an application for membership.

#### Membership Application

A membership application form has four main parts: Statement of the desire of the applicant to become a member of the cooperative; signature of the applicant; statement of acceptance of applicant; and signatures of the president and secretary of the cooperative.

It is extremely important that any cooperative have a properly completed membership application from every member. Membership, and the amount of business done with members and nonmembers, if any, may become important.

The membership application, signed by the member and approved by the board of directors, is the best legal proof that a patron of the cooperative is actually a member.

#### Membership and Revolving Fund Certificates

On his acceptance into the cooperative, each member is issued a membership certificate as evidence that he is entitled to all of the rights, benefits, and privileges of the association.

A revolving fund certificate is the member's receipt for certain capital contributions that will eventually revolve back to him; in the meantime they are retained by the cooperative to be used as association capital.

These contributions may be deductions made from the returns from his products, patronage dividends left in the business and credited to him on the books, or original capital subscriptions to a nonstock cooperative.

#### Filing the Articles of Incorporation

By filing the articles of incoporation with the proper State office, the cooperative corporation is brought into being.

The organizing committee does the filing, first making sure that all requirements are met. Requirements include: Evidence of the minimum paid-in capital; evidence of a minimum payment on stock subscriptions if the corporation is to be a stock company; and, in most States, acknowledgment of the articles by some of the original incorporators.

A fee for recording the articles of incorporation must be paid when they are filed.

# FIRST MEETINGS OF MEMBERS AND BOARD

#### **Charter Members**

According to most statutes under which cooperatives are organized, bylaws must be adopted by a majority vote of members or stockholders.

For convenience in organizing the cooperative, only the persons named in the articles of incorporation attend the first meeting as charter members of the cooperative to adopt the bylaws. These persons are generally regarded as members or stockholders as soon as the articles of incorporation are filed.

Further action is usually needed to make members or stockholders of those who have subscribed for stock or agreed to become members but who are not named in the articles of incorporation. Under some statutes, however, the incorporators can adopt the bylaws as incorporators rather than as members or stockholders.

Before the meeting, each charter member should

sign a waiver of notice of the meeting. This is necessary because he has not received such a notice.

A temporary chairman conducts this first meeting. The filing of the articles of incorporation may be reported. Then a draft of the proposed bylaws is presented. The bylaws are discussed and adopted as read or as amended, and each member signs them.

If the first board of directors has not been named in the articles of incorporation, they should be elected at this meeting.

#### **Board of Directors**

The board of directors should hold a meeting as soon as possible after the bylaws have been adopted. At this meeting they take the numerous actions necessary to make the cooperative a going concern, ready to begin operations.

Usually this meeting is held immediately after the first meeting of members and no legal notice of the meeting has been sent to the directors. Therefore each director signs a "waiver of notice" before the meeting.

Items of business at this first board of directors

meeting include:

- Electing the first officers of the association.
- Adopting a form of membership application or stock subscription.
- Adopting the form of marketing agreement if one is to be used.
  - Selecting a bank to do business with.
- Designating officers or employees to be authorized to handle funds and issue checks.
  - Arranging for bookkeeping and auditing.
- Arranging for printing and distribution to all members of copies of the articles of incorporation and the bylaws.
- Arranging for bonding officers and employees in accordance with bylaws.
- Arranging for securing a location and facilities for doing business.
- Transacting other business, such as insuring and bonding the manager and other key employees.
  - Selecting the manager.

The qualifications of a cooperative manager in-

clude those for a manager of any business. He must be experienced and efficient in the work he is to do His integrity must be unquestionable. He must have good judgment in business matters and be alert to adopt improved methods.

In addition, he should be sympathetic to cooperative principles and ideals and be able to develop membership confidence and loyalty.

To accomplish some of the bigger jobs in getting the business started, the board may create special committees.

The job that probably takes the most foresight and judgment is acquiring a business establishment—the site, building, machinery, and other equipment. The way this job is done will influence the operations of the cooperative for many years. The newly selected manager should participate in these decisions.

Even though the survey committee has done much spadework in investigating possible sites and buildings, the directors will need to look into the matter thoroughly on their own.

They should consider such possibilities as renting a building now vacant, leasing land, buying good secondhand equipment. At any rate they will want to avoid using so much capital for a place of business that little is left for operating purposes.

# GENERAL RULES FOR

Several basic rules for successful formation of a cooperative apply to more than one step of the process. These are summed up below.

#### Study Applicable Laws

There are laws that pertain to cooperatives only and laws that pertain to all businesses. You should know what rights these laws establish for your cooperative, what limitations they impose, and what specific actions must be taken to comply with laws.

The Capper-Volstead Act of 1922, a Federal law, is known as the "Magna Charta" of farmer cooperatives. This act recognizes the rights of producers to act together in associations without having this action put them in restraint of trade.

Several other Federal statutes give cooperatives the right to operate within acceptable frameworks and do business alongside other types of business. The Farm Credit Act of 1933 defines a cooperative association that is eligible to borrow from a district bank for cooperatives and the conditions the cooperative must meet.

## SUCCESS

Every State has one or more laws authorizing the forming of cooperative corporations. You can obtain copies of these laws from your attorney or from the proper State official, usually the Secretary of State or Corporation Commissioner.

The Internal Revenue Act of 1962 has two sections—17 and 19—that apply to the tax treatment of farmer cooperatives and their patrons and tax reporting requirements. (See list on back cover for publications on Federal income taxes.)

State and local tax and license regulations also apply to various kinds of businesses.

#### Get Expert Help

At various stages in the setting up of a cooperative you will need the advice of experts in special fields, especially in law and accounting.

You will need an attorney to help you draw up the organization documents or check the legality of those you draw up. You will need him when you acquire real property, when you work out capitalization plans, and, possibly, when you borrow money. You will need an accountant to help you set up a bookkeeping system and work out the mechanics of your revolving capital plan. You will need one to audit the association books and possibly to help prepare and file reports for income tax purposes.

In addition, you may from time to time need the technical advice of engineers and other technicians and of persons experienced in the special kind of cooperative business you are undertaking.

If you are setting up a cooperative to market livestock, for example, you will need the advice of someone who has had experience in marketing livestock. Your best source of this help will probably be another livestock marketing cooperative or a representative of a district bank for cooperatives.

#### Conduct Businesslike Meetings

A cooperative is primarily a business. Therefore all meetings should be conducted in a businesslike way.

Parliamentary procedure is a pattern for orderly, democratic group action. Using it, a chairman can lead a group smoothly and efficiently to the determination of the wishes of the majority, while at the same time protecting the rights of the minority.

#### Let Manager Manage

In some cooperatives that are small or whose services are limited, a member of the board of directors may manage the day-to-day business. For most cooperatives, however, there is a basic distinction between the roles of directors and manager.

The board of directors represents the members in the overall conduct of the affairs of the cooperatives. In this capacity, it sets basic policies and objectives, employs a manager, and periodically reviews the business operations to make sure that they are in keeping with association policies and objectives.

The manager is responsible for planning a program that will carry out policies and objectives determined by the board of directors. Normally the manager is responsible for hiring employees to do the work.

Cooperative experience shows that directors should not interfere with the day-to-day management of the cooperative, and that managers should not attempt to set policies. Each has a separate function to perform.

#### Keep Board Flexible

Some cooperatives have trouble getting rid of unsatisfactory directors. Some have trouble changing directors regularly in order to benefit from new ideas and fresh approaches.

Both of these troubles can be avoided by providing for the following in the bylaws:

- Staggered terms of office, so that not all experienced directors go off the board in the same year.
- Requiring at least two nominees for each vacancy on the board.

In addition, the following provisions will help insure a truly democratic election:

- A nominating committee to present a panel of nominees at the annual meeting when directors are elected. No director should serve on this committee.
- Allowing written nominations from members, submitted before the meeting. Some cooperatives also may want to allow nominations from the floor.
  - Voting by secret ballot.

#### Provide for Reasonable Quorum

A quorum is the number of members required by law or the bylaws to be present at a member meeting where official business is carried on. Sometimes this quorum is expressed as a percentage of the membership.

It is wise to keep the quorum relatively small if this is permissable under State law. If the quorum is set too high it is sometimes difficult to get enough members at a meeting to transact business.

Many cooperatives require different quorums for different kinds of business.

#### Start Conservatively

"Start conservatively," is a good general rule. It is easier to begin modestly and expand than to retrench from an overambitious start. From the very beginning, however, the volume of business must be sufficient to support the overhead and other expenses and to afford a margin of savings.

Be realistic in outlining the probable advantages of the cooperative to prospective members, and the risk involved. Frequently those most eager to get the cooperative started "oversell" the benefits to be expected. This can lead to disappointment.

#### **APPENDIX 1. SAMPLE** SURVEYCOMMITTEE REPORT

#### **Decisions of Planning Committee, Poultry Cooperative**

I.

	Committee Decision
Operating Costs and Volume of Business:	
1. How much will the operating costs be and how will they be met?	e
RentalSalaries per month:	
Manager (1)	_ 500
Delivery (1)	_ 250
Certification (1)	
Clerk (1)	
Pickup (1)	
Other costs per month:	
Trucks (2) (operation and depreciation)	_ 400
Electricity, water, telephone	
Supplies (fillers and flats—cases)Seals	-) 1,400
Taxes Workmen's compensation insurance All others	_ 75 }
Operating expenses—manager	
Audit	25
	\$4,140
2. What is the least volume necessary to meet overhead costs Are there enough producers willing to join a cooperative to guarantee the minimum volume?	ve 2000 cases a month or
3. What will be the policy on purchasing supplies for members Price to members? Delivery to members?	
4. Will members' produce be picked up at the farm? Or be de livered to cooperative? Or delivered to buyer?	
5. How much capital will be required:	
Cost of fixed capital:	
Pickup truckStake 1½ ton	
Office equipment:	
Typewriter	
Adding machine	
Duplicator	
File	_ 50 475
Sizing machine	_ 1,500

	Chill room Miscellaneous Record books and set up—co-op books Attorney's fees Recording fee	150 200
	Retainer fee (lawyer)	$ \begin{array}{c} 7,325 \\ 1,000 \\ \hline \$9,000 \end{array} $
II.	Outlets and Proposed Marketing Methods:	-
	1. Often it is advisable to confine marketing operations to one trade group, i.e., retailers or wholesalers. Trying to sell to several groups may arouse antagonism from one or other of established business groups. What does the committee suggest in this respect?	
	2. What reception does the committee anticipate the cooperative will meet from potential customers and competitors now in business?	Deal with members'
	3. Will the cooperative establish its own place of business with a complete sales and delivery force, or will it employ an agent on a contract basis?	
	4. Will the policy be to market a uniform product that can be standardized under supervision of the cooperative management, and labeled and advertised as a cooperative product, or to act as an agent for produce packed on the members' farms?	Co-op—brand—certified.
	5. What will be price policy on sales?	General market price.
III.	Organization and financing:	
	1. Where will the place, or places, of business be established?	County-seat and pick-up stations.
	2. Scope: How many products will the cooperative attempt to handle at the beginning? Later?	Feed later. Egg sales only at first.
	3. From how big an area will members be accepted? The State? One country? Or one district?	County-wide.
	4. What name is suggested?	
	5. Financing: Will the cooperative be incorporated or not? Will it be a stock organization by which capital is raised from the sale of interest-bearing stock certificates, or a non-stock cooperative that requires only membership fees? Usually this is decided by the amount of capital required	corporation. Financing
	6. Membership: Will there be any limitation on the least volume of business that possible members will give to the cooperatives?	See IV—1
	7. How many potential members are there, and how many of them will join a cooperative?	
	8. What will be the membership fee?	

Committee Decision

5. How much capital will be required:—Continued.

- 9. What plan is proposed to secure maximum membership? \_\_\_
- 10. Will the cooperative do business with non-members? To what
- 11. How will the Board of Directors be chosen? On the basis of size of business, by districts, at large, or a combination? What fees and expenses will be paid to Directors? \_\_\_\_\_
- 12. Manager: What type of manager will be employed? At what salary? What will his duties and authority be in relation to the Board of Directors?
- 13. What reports will the manager and Board of Directors give to members? How often?

#### Hold a meeting of all members.

No business with non-members.

One large and one small producer in each district. Fee \$5.00 a meeting.

Directors set policy. Manager carries out and makes full report.

Monthly meetings and report to members.

#### IV. Marketing Agreement:

- 1. To establish a new business there must usually be a guarantee of a certain volume of business. How shall member contracts of volume be made? On an estimated quantity per month? Or a percentage of total production?
- 2. Meeting the cost of operating a business requires certain deductions from gross returns. Shall deductions be on a fee per unit sold, or on a percentage of dollar sales?
- 3. How long a period shall the marketing agreement cover? \_\_\_\_
- 4. What will be the penalties for noncompliance of members? What escape clauses will be allowed members in the contract? What escape clauses for the cooperative?

Ninety percent of total marketable eggs produced with exception that may be made between Board of Directors of the cooperative and individuals.

Operating margin based on flat fee per dozen.

Five years, but members can withdraw during month of February in any year by giving 30 days written notice.

One hundred dollars fine plus loss that co-op may have incurred due to breach of contract. Escape clauses will cover member's failure to deliver because of causes beyond his control. Same for cooperative.

### APPENDIX 2. SAMPLE ORGANIZATION AGREEMENT

(Alternate paragraphs for use of associations organized on a capital stock basis are indented in brackets.) The undersigned, a producer of agricultural products, hereinafter referred to as "Producer," together with other signers of agreements similar hereto, for the purpose of engaging in \_\_\_\_\_\_ (In this space broadly state purposes for which association is to be organized) propose to organize a cooperative association without 1 capital stock under the laws of\_\_\_\_\_\_ \_\_\_\_\_, as hereinafter provided, and in consideration of the premises, hereby agrees for himself and for the express benefit of and for the association to be organized, as follows: 1. (a) The association shall be organized with suitable articles of incorporation and bylaws as determined by an organization committee consisting of the following persons (State names and addresses of committee members): (b) This committee may, in the discretion of a majority thereof, increase its membership, fill any vacancy therein, and appoint any committees deemed necessary to conduct the details of its affairs. The committee, or any committee designated by it, may prescribe an organization fee to be paid by each person signing an organization agreement similar hereto and may incur necessary obligations, make necessary expenditures, and take any such action as may, in its discretion, be deemed advisable to further the organization of the association. 2. The bylaws of the association shall provide, among other things, that \_\_\_\_\_\_ (Here enumerate the chief provisions which it is proposed shall be contained in the bylaws) 3. If, on or before\_\_\_\_\_, 19\_\_ the organization committee is of the opinion that sufficient sign-up has been obtained to enable the association to operate efficiently, the committee shall, by notice to be published in one or more newspapers of general circulation in the area in which those who sign agreements like this one reside, specify a date and place for a meeting of those who sign such agreements to enable those attending such meeting conclusively to determine, by majority vote, if a sufficient sign-up has been obtained to justify the formation and operation of the association, and to consider such other business as may be deemed expedient. Notice of the action there taken shall be published in one or more newspapers of general circulation in the area. 4. The organization committee shall keep full, true, and detailed accounts of all receipts and of all expenditures of every kind and shall have such accounts audited and render a written report thereof to the board of directors of the association when organized, and shall thereupon turn over to the association any balance remaining in its hands free of obligation. If the association is not so organized, such unexpended balance shall be prorated among those who contributed thereto. 5. Producer hereby subscribes for\_\_\_\_\_ revolving-fund certificates, each of the face value of \$\_\_\_\_\_ and agrees to pay therefor as follows:

<sup>&</sup>lt;sup>1</sup> If association is to be formed with capital stock, "without" should be changed to "with."

If association is to be formed with capital stock, the following may be substituted for paragraph 5:

"Producer agrees to purchase and does hereby subscribe for one share of voting common stock of the association, par value \$\_\_\_\_\_ payable on demand following the acceptance hereof, and \_\_\_\_\_\_ shares of nonvoting preferred stock of the association, par value \$\_\_\_\_\_ each, and agrees to pay for same as follows:

\$\_\_\_\_\_\_ on or before \_\_\_\_\_\_, 19\_\_\_\_ \$\_\_\_\_\_ on or before \_\_\_\_\_\_, 19\_\_\_\_

It is understood that certificates for such preferred stock shall not be issued and that no dividends shall be paid thereon until such shares have been paid in full. Producer hereby authorizes and directs the association to apply any and all dividends or distributions accruing to him during any year to the payment of any or all installments due or which may be due on such stock subscription for that year or for any prior year."

6. Producer applies for membership in the association when organized and expressly agrees that signature to the marketing agreement shall be deemed to all intents and purposes the same as signature to this organization agreement, all of which shall be irrevocable, except as provided in section 3 of this organization agreement and section 12 of the marketing agreement or the bylaws of the association, and he so agrees in order to induce other producers to sign agreements like this one for his benefit as well as for their own general benefit.

If an association is formed without capital stock and is not to use a marketing agreement, the following may be substituted for paragraph 6:

"Producer applies for membership in the association when organized and expressly agrees that signature hereto shall be irrevocable, except as provided in section 3 hereof or in the bylaws of the association, and he so agrees in order to induce other producers to sign agreements like this one for his benefit as well as for their own general benefit."

If association is to be formed with capital stock and is to use a marketing agreement, the following may be substituted for paragraph 6:

"Producer hereby agrees that his signature to the marketing agreement shall be deemed to all intents and purposes the same as his signature to this organization agreement, all of which shall be irrevocable except as provided in section 3 of this organization agreement and section 12 of the marketing agreement or the bylaws of the association and he so agrees in order to induce other producers to sign agreements like this one for his benefit as well as their own general benefit."

If an association is to be formed with capital stock and is not to use a marketing agreement, the following paragraph may be substituted for paragraph 6:

"Producer hereby agrees that his signature hereto shall be irrevocable, except as provided in section 3 hereof or in the bylaws of the association, and he so agrees in order to induce other producers to sign agreements like this one for his benefit as well as their own general benefit."

7. Acceptance hereof shall be deemed conclusive upon the mailing, by the association, of a notice to that effect to Producer at his address noted below, and such mailing and notice shall be conclusively established by the affidavit of the secretary of the association.

8. Subject to the terms hereof, Producer agrees to be bound by the terms of the following marketing agreement, which, on the acceptance hereof by the association, may be used separate from this organization agreement.

If it is desired to provide for the filing or record of marketing agreements, the following should be added at the end of the last sentence above: "and, upon demand of the Association when organized, to execute an agreement in like form and to acknowledge the same, if required, so as to entitle it to be filed of record."

This paragraph and other provisions herein relative to marketing agreements should be included only in the case of marketing associations and if no marketing agreement is used provisions should be made for dating and for the signature and address of the Producer following paragraph 7.



#### FOR MORE INFORMATION

More detailed information on particular steps in the cooperative-forming process is contained in other publications of the Farmer Cooperative Service listed below. Single copies of these publications may be obtained by writing the Farmer Cooperative Service, U.S. Department of Agriculture, Washington, D. C. 20250.

Financing Farmer Cooperatives—Educational Circular 5

Managing Farmer Cooperatives—Educational Circular 17

Sample Legal Documents for New Cooperatives—FCS Educational Circular 19

How the Revenue Act of 1962 Affects Farmer Cooperatives—General Report 105

Improving Management of Farmer Cooperatives—General Report 120

How the Adjustable Revolving Fund Capital Plan Works—General Report 111

"Mr. Chairman-"-Information 6

What Are Patronage Refunds?—Information 34

